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No. 272

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

JESSE JOHNSON and VIRGINIA D. JOHNSON, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR THE PETITIONERS

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Upon analysis it will be seen that the brief for respondent in opposition to petition for a writ of certiorari in the instant case accentuates the importance of granting the writ and clearly discloses the fact that the opinion below is in direct conflict with decisions of this Court and with decisions of Courts of Appeals for other circuits.

1. The opposition brief relies upon *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451, 94 L. Ed.

251, 38 AFTR 978 (1950), *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 89 L. Ed. 981, 33 AFTR 593 (1945), *Higgins* v. *Smith*, 308 U.S. 473, 84 L. Ed. 406, 23 AFTR 800 (1940), *Minnesota Tea Co.* v. *Helvering*, 302 U.S. 609, 82 L. Ed. 474, 19 AFTR 1258 (1938) and *Griffiths* v. *Commissioner*, 308 U.S. 355, 84 L. Ed. 319, 23 AFTR 784 (1939). In those cases the stockholders had full control of the corporations and were in a position to require the corporate entities to do their bidding without a dominant and controlling adverse preferred stockholder to prevent their doing so, which is the opposite of the situation in the instant case. In each of those cases the basic question was whether the corporate entities had been used by their controlling stockholders as a sham for no business purpose in order to avoid taxation. Surely those cases can have no bearing in the instant case which involves a Federal Housing Administration dominated and controlled corporation designed "to accomplish the Congressional aim expressed in the National Housing Act" which "corporation is not an independent commercial entity". *Loftus* v. *Mason* and *Shirley-Duke Apartments* v. *Mason*, 139 F. Supp. 207 (1956) and *Sarner* v. *Mason*, 228 F. 2d 176 (CA 3, 1955) cert. denied 351 U.S. 924, 100 L. Ed. 600 (1956).

2. The opposition brief does not mention *Moline Properties, Inc.* v. *Commissioner of Internal Revenue*, 319 U.S. 436, 87 L. Ed. 1499, 30 AFTR 1291 (1943) relied upon in the petition for certiorari. The opinion below is in direct conflict with the opinion of this Court in *Moline Properties, Inc.* and under the principles there established it is perfectly clear that Frederick Courts, Inc., dominated and controlled by FHA as preferred stockholder, is not the alter ego of Jesse

Johnson who performed a construction contract for that corporation—dictated in every detail by FHA—in the regular course of his life-long business as a builder.

3. The opposition brief does not mention *Loftus* v. *Mason* and *Shirley-Duke Apartments* v. *Mason, supra,* in which the opinion, *dealing with identical charter and contractual provisions,* makes it perfectly plain that the position taken below is in direct conflict with the FHA windfall cases.

4. The attempted distinction with respect to *Sarner* v. *Mason, supra,* mistakenly *confuses the wrongful power to violate legal rights with legal rights themselves.* Even assuming that Mr. Johnson could have surreptitiously increased the contract price to cover his loss as a builder and made a charge against Frederick Courts, Inc., such wrongful act would clearly have constituted a violation of the FHA dictated charter and contractual provisions subjecting both Mr. Johnson and Frederick Courts, Inc. to the consequences thereof. Obviously in imposing the charter and contractual provisions here involved it was the purpose of FHA to prevent such wrongful violations and inasmuch as FHA and Mr. Johnson recognized that he had no legal right to pass his "hard luck" $130,635.15 loss on to Frederick Courts, Inc. it was properly deductible under the Internal Revenue Code.

5. The opposition brief does not mention *Wadsworth Manufacturing Co.* v. *Commissioner of Internal Revenue*, 44 F. 2d 762, 9 AFTR 441 (CA 6, 1930) and *Rankin* v. *Commissioner of Internal Revenue*, 60 F. 2d. 76, 11 AFTR 706 (CA 6, 1932) from which it is clear that the opinion below is in direct conflict with

the principles established by the Court of Appeals in those cases.

6. Just as FHA authorized the construction contract price in the first instance, the opposition brief recognizes that "With the approval of the F.H.A., it was increased" by $150,000, i.e., from $1,163,640 to $1,313,640 (p. 4) to cover improvements in materials which FHA recognized as increasing the economic and rental value of the apartment project. The brief also recognizes that FHA *refused to sanction* any contract price increase to cover the $130,635.15 loss here involved which was determined by FHA to have not resulted in any economic benefit to Frederick Courts, Inc. In its footnote on pages 4 and 5 the brief then, however, seems to contend that because $100,000 of the FHA *authorized* increase was paid through additional insured loan and the remaining $50,000 of the FHA *authorized* increase was charged to be paid "when funds are available" Mr. Johnson should have taken steps to charge the *unauthorized* $130,635.15 loss also. This reasoning is worse than a *non sequitur*. The *opposite* conclusion follows therefrom inasmuch as it is clear that without an *authorized* contract price increase there was simply nothing that could properly be charged to Frederick Courts, Inc.

7. The opposition brief does not mention the fact that after reviewing the Court of Appeals' opinions on the subject it was held in *D. W. Pierce*, 41 BTA 1261 (1940) that the authorities "point to the conclusion that outlays made by an owner-investor may not be considered capital contributions when they are paid to outsiders and engender only a secondary or indirect benefit for the capital invested". *D. W. Pierce, supra,*

was acquiesced in by the Commissioner of Internal Revenue as correctly stating the principles involved.

8. There is clearly nothing in *Helvering* v. *National Grocery Co.*, 304 U.S. 282, 82 L. Ed. 1346, 20 AFTR 1269 (1938) or *Comstock* v. *Group of Investors*, 335 U.S. 211, 92 L. Ed. 1911 (1948) that militates against petitioners' position. Footnote 5 in *Helvering* v. *National Grocery Co., supra*, relied upon in the opposition brief, deals with fraud, profit motive, and planned avoidance of taxation by foreign corporations and does not have the remotest bearing here. This Court's five to four opinion in *Comstock* v. *Group of Investors, supra*, supports petitioners because the "legal import" of the "unchallenged facts" shows error below with exceptional clarity.

9. Most important of all, the opposition brief does not mention the fact that judicial sanction has been given below to principles which permit a citizen to be whipsawed to his economic ruin between diametrically opposite holdings of two agencies of the Federal Government. FHA's holding that the $130,635.15 loss was Jesse Johnson's "hard luck" to be borne and absorbed by him resulted in Mr. Johnson's insolvency. The Commissioner of Internal Revenue's holding to the contrary sustained below adds the $10,188.74 tax deficiency here involved to Mr. Johnson's economic disaster. This situation calls for the exercise of the Court's power of supervision to prevent such an unwarranted departure from the accepted and usual standards of fairness followed in the administration of justice.

CONCLUSION

For the reasons stated above and in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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September 1956.